Euro wrap-up

Overview

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- Gilts recorded massive gains as the BoE surprised the market by keeping Bank Rate and its QE programme unchanged.
- Despite a further jump in euro area PPI inflation, Bunds followed Gilts higher as German factory orders fell short of expectations and the final services PMI confirmed a slowdown at the start of Q4.
- Tomorrow will bring a number of data releases including euro area retail sales, German, French and Spanish IP and a UK labour market survey.

Daily bond market movements

Bond	Yield	Change
BKO 0 09/23	-0.730	-0.058
OBL 0 10/26	-0.564	-0.083
DBR 0 08/31	-0.227	-0.056
UKT 0¹/₈ 01/24	0.461	-0.209
UKT 0³/₈ 10/26	0.628	-0.199
UKT 0¼ 07/31	0.931	-0.136

*Change from close as at 4:30pm GMT.
Source: Bloomberg

Euro area

German factory orders remain down from spring peak

Having been particularly strong through to the spring, German factory orders data have since disappointed, showing signs of softening demand as supply bottlenecks persist. Today's data showed that orders rose a softer-than-expected 1.3%M/M in September following a steeper-than-initially-estimated drop in August (-8.8%M/M), which was the third-sharpest on the series. Growth in September was only due to a sharp rebound in orders from other non-euro area countries (14.9%M/M), with domestic orders down for the third consecutive month (-5.9%M/M). Moreover, orders of machinery and equipment (+12.2%M/M) were reportedly boosted by a surge in bulk orders, while new orders of motor vehicles were up 9.6%M/M only partially offsetting the 12.6%M/M drop in August. Indeed, when excluding major items, new factory orders were up just 0.2%M/M in September, following a decline of 5.8%M/M previously. So, while underlying orders (excluding major items) remained 4% higher than the pre-pandemic level, they were down by more than 3½%Q/Q in Q3, tallying with the slowdown recently reported in the ifo and PMI surveys.

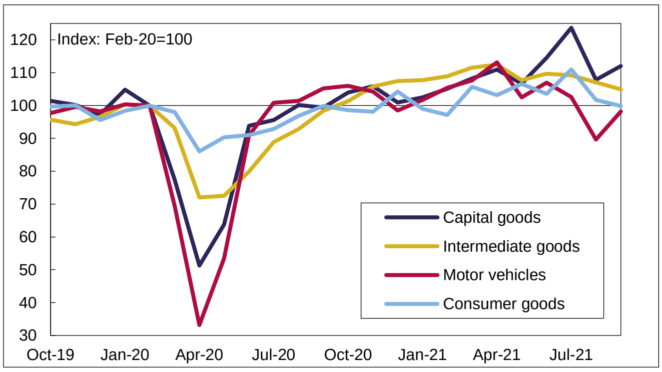
German manufacturing turnover falls to lowest since June 2020

Despite the recent downwards trend, the level of orders in most subsectors remains close to or higher than the pre-pandemic level – intermediate goods orders are almost 5% higher, capital goods orders are 12% higher and consumer goods orders are just 0.1% lower – suggesting that, as and when supply chain disruption eventually eases, production should rebound. For now, however, today's manufacturing turnover data – which typically offer an insight into production for the same month – suggested another subdued outturn in September. Indeed, following a drop of 5.8%M/M in August, turnover was down a further 0.3%M/M to its lowest level since June 2020, more than 10% lower than the pre-pandemic level and down 3%Q/Q in Q3. Therefore, today's data certainly suggest that tomorrow's IP data will likely fall short of the current Bloomberg consensus forecast of +1.0%M/M.

Producer price inflation exceeds expectation yet again to hit new highs

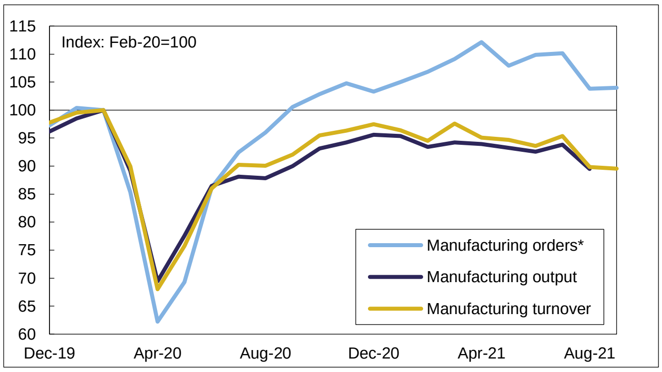
Once again, euro area industrial producer prices surpassed expectations, posting a record monthly increase of 2.7%M/M in September, to be up 16.0%Y/Y, a new annual series high. Perhaps inevitably, given the increase in pressures in wholesale power markets, energy remained the main driver, with prices up 7.7%M/M to push the annual growth rate up to a new high of above 40%Y/Y. Electric power producer prices were up 37.1%Y/Y while prices of gas production and distribution rose more than 51%Y/Y. And prices of extraction of natural gas rose more than 140%Y/Y with extraction of oil and petroleum up almost 130%Y/Y. Inflation of intermediate items rose again too, with prices rising 1.0%M/M to push the annual rate up to a new

Germany: Factory orders by subsector



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: Factory orders, turnover and output



**Excluding major items. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

euro-era high of 15.2%Y/Y, with prices of chemicals up more than 30%Y/Y and metals up 20%Y/Y. And there was evidence of increased pass-through of inflation to other categories, with producer inflation of capital goods and consumer durables up to new highs of 3.5%Y/Y and 4.0%Y/Y respectively. Given ongoing pressures in wholesale markets, energy inflation looks set to remain exceptionally high for some times, with the likelihood of further pass-through to other categories of factory prices – and final consumer prices – over the coming six months or so too. However, while power prices would seem at risk of additional pressure should the northern hemisphere winter prove much colder than usual, the recent decline of more than one third in the benchmark Netherlands gas price since Russia signalled a greater willingness to pump to Europe underscore the likelihood that energy prices will likely subtract from producer price inflation by the end of next year.

Services PMI point to moderating activity amid rising prices

Intensifying price pressures were a key feature in the services PMI survey in October. And the final release today showed an even steeper rise than initially reported in the euro area's input price index, up 2.3pts from September to 67.5, the highest for more than 21 years. And while the increase in the prices charged index was a touch softer than in the flash estimate, at 55.8, it was similarly the highest since September 2000. While backlog of works eased back as services firms increased their workforces at the fastest pace in 14 years, firms also signalled a further moderation in the pace of expansion at the start of the fourth quarter. Indeed, the euro area activity index fell 1.8pts to 54.6, a six-month low, to be 5pts lower than the peak in August. And despite a pickup in tourism as international travel restrictions continued to ease, new business growth slowed marginally. Within the country detail, Germany reported the largest monthly decline in the headline PMI, down 3.8pts to 52.4, with a sizeable drop in the new business component too. This contrasted with France, which saw the headline index rise to a three-month high (56.6) and indicate the strongest growth of the larger member states. Among the periphery countries, Italy's activity PMI fell by the most since November (-3.1pts) to 52.4, while the Spanish services PMI fell for the fourth consecutive month to 56.6.

The day ahead in the euro area

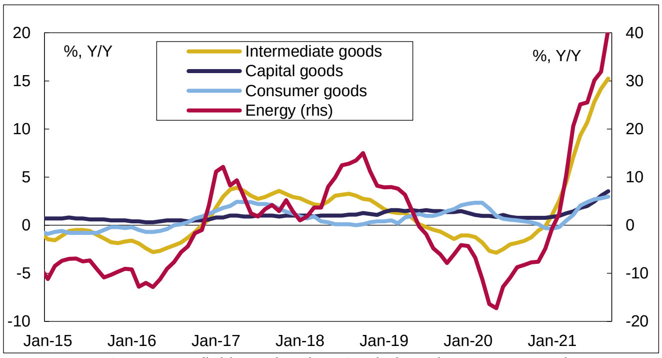
The euro area economic data calendar concludes tomorrow with the release of September retail sales figures for the region as a whole, which will provide some further insight into household consumption at the end of the third quarter. Not least given increased opportunities to spend on consumer-facing services and following some weak German retail sales figures earlier this week, aggregate euro area sales might well report a drop at the end of the quarter despite initial expectations of further moderate growth. Tomorrow will also bring the aforementioned German IP release, along with September production data from France and Spain. Manufacturing production seems bound to have remained hindered by ongoing supply challenges. And the latest construction PMIs will likely flag ongoing supply-related challenges in that sector at the start of the fourth quarter too.

UK

BoE leaves rates and QE unchanged despite recent hawkish commentary

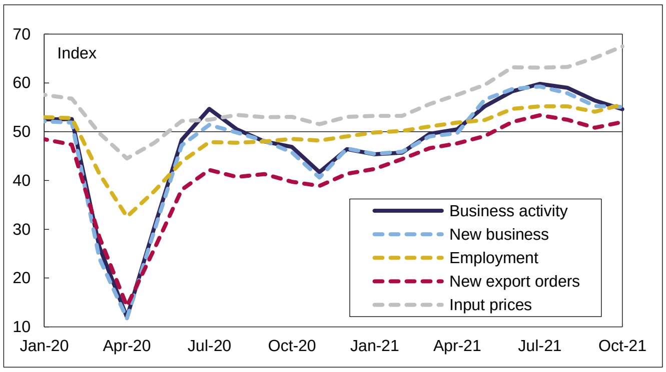
While a number of MPC members had over recent weeks signalled that BoE monetary policy will likely need to be tightened, today it unexpectedly voted to leave Bank Rate and its asset purchase target unchanged. Only two members (Deputy Governor Ramsden and external member Michael Saunders) out of the nine voted to raise Bank Rate. And with them, only one further member (the external Catherine Mann) voted to bring the Bank's Gilt purchases to an early conclusion before its long pre-determined end next month. Nevertheless, in the post-meeting press conference, BoE Governor Bailey stated that the decisions had been finely balanced. And the post-meeting statement made clear that, if incoming data, particularly with respect to the labour market, are broadly in line with the BoE's central expectation, the MPC will likely see it necessary over coming months to increase Bank Rate. However, the projections based upon a market-implied path for Bank Rate – under which it rises to around 1% by the end of 2022 – see inflation fall below the 2% target by the end of the forecast period,

Euro area: Producer price inflation



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Services PMIs



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

with a notable margin of spare capacity also emerging by then. So, while Bank Rate is still likely to rise over the coming twelve months, the BoE projections suggest that the path of tightening is likely to be less marked than has been priced into markets before the announcement. And as the policy decision and vote jarred somewhat with recent communication, not least from Governor Bailey and Chief Economist Pill, Gilts rallied significantly and the curve steepened on the announcements. So, bemoaning the recent lack of nuance, many commentators suggested that the resulting volatility raised questions about the BoE's credibility.

Near-term GDP growth outlook revised down, near-term inflation outlook revised up

In its post-meeting statement, the MPC acknowledged that, partly due to supply bottlenecks, UK (and global) GDP had slowed more abruptly in Q3 than it had anticipated three months ago, and noted signs of weaker consumption. And so, in line with our own forecast, it put back by one quarter to Q122 the point at which GDP Is likely to return to its pre-pandemic level. Moreover, despite the Government's recent decisions to boost public spending, it judged that, after moderating further over the course of next year, UK GDP growth is likely to be subdued from 2023 onwards as potential supply growth moderates to around 1½%Y/Y and as higher energy prices and fading policy support weigh on demand growth. Overall, the BoE revised down its GDP forecasts for this year (by ¼ppt to 7.0%Y/Y) and next (by 1ppt to 5.0%Y/Y), with a further slowdown to 1.5%Y/Y in 2023 and just 1.0%Y/Y in 2024. In contrast, the BoE revised up significantly its near-term inflation forecast. Due principally to higher utility bills, it expects inflation to rise to just under 4%Y/Y in October, to 4½%Y/Y in November and remain around that level through the winter, before peaking close to 5.0%Y/Y in April. But inflation is also expected to fall back significantly from H222 as supply disruption eases, global demand rebalances away from goods towards services, and energy prices stop rising. Based on market rate assumptions, inflation falls below 2.0%Y/Y in early 2024, but on unchanged policy inflation remains several tenths of a percent above 2.0%Y/Y over the horizon.

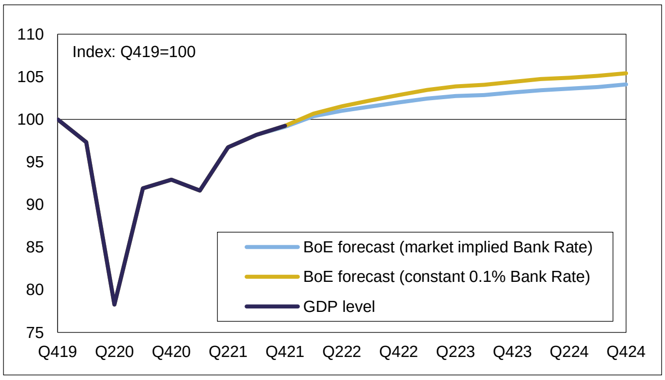
Labour market to be key for policy

Seemingly most important for the medium-term inflation outlook – and hence monetary policy – will be developments in the labour market, which remain highly uncertain. While over a million jobs – much more than the BoE had expected – are estimated still to have been supported by the Job Retention Scheme ahead of its termination at end-September, the MPC took comfort from the recent declines in unemployment, limited signs of an increase in redundancies and the jump in vacancies. And while unemployment is still expected to rise slightly in the current quarter, the Bank again judged that underlying pay growth remains above pre-pandemic rates. While pay growth is expected to fall back so that real wages decline in both 2022 and 2023, the Committee also judged that the risks to inflation from wages are skewed to the upside. With two UK labour market reports to be published before the next monetary policy meeting on 16 December, the Committee might then decide that those risks have become sufficiently high to raise rates just in time for Christmas. However, since the MPC hesitated today, a first hike in Bank Rate this cycle to 0.25% might now seem more likely when the Bank's forecasts are updated in February, with one further to increase to 0.50% also perhaps likely in H222 too.

UK car registrations the weakest in any October since 1991

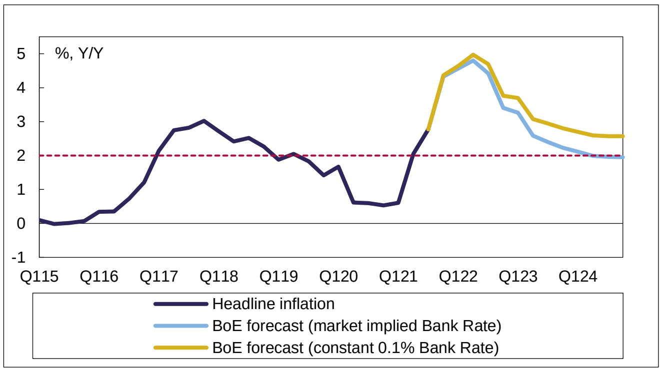
Today's UK data continued to illustrate the recent moderation of GDP growth momentum, not least due to persisting supply bottlenecks. In particular, new car registrations fell for a fourth consecutive month in October, by a further 25%Y/Y to just 106k units, the weakest October outturn since 1991. So, in the first ten months of the year, car sales were up less than 1½%YTD/Y despite the low base a year ago. Indeed, compared with the equivalent periods in the five years before the pandemic, registrations were down by almost a third. And this was despite the sharp uptake in electric cars, of which SMMT forecast will be greater in 2021 than during the whole decade before the pandemic. With production likely to remain hampered by supply chain disruption, there are clear downside risks to SMMT's recent forecast for annual sales of 1.66mn, which would require sales to be unchanged compared with a year earlier in both November and December. Indeed, aside from the pandemic-impacted 2020, full-year registrations in 2021 will prove to be the lowest since 1992.

BoE: UK GDP forecasts



Source: BoE and Daiwa Capital Markets Europe Ltd.

BoE: UK inflation forecasts



Source: BoE and Daiwa Capital Markets Europe Ltd.

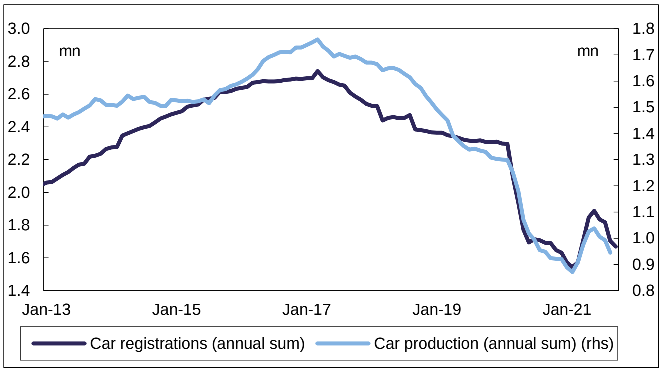
Construction PMI suggests very modest easing in supply constraints

With UK construction output having declined in three of the past four months, the PMI survey for the sector was somewhat more encouraging at the start of the fourth quarter. In particular, the headline activity index rose for the first time since June, by 2pts to 54.6, with house building reportedly the best-performing subsector. But the output indices from all subsectors remain considerably lower than the peaks in June – e.g. the headline PMI in October was down by 11.7pts and only slightly stronger than the long-run average. And new orders growth was little changed at the start of the fourth quarter, and well below the average seen over the summer, as firms suggested that supply shortages and mounting costs had hindered some contract negotiations. Certainly, while today's survey reported some easing in supply constraints to their least severe since April, more than half of respondents still reported longer delivery times. And despite falling back in October, the input price PMI remained extremely elevated at a rate well above the long-run average.

The day ahead in the UK

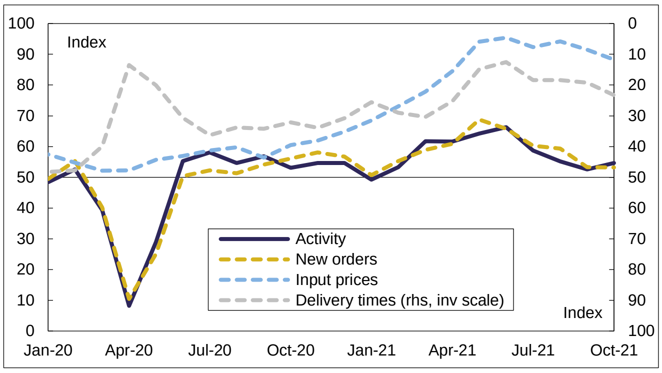
The week comes to a close quietly for UK economic data, with only the REC/KPMG report on UK jobs scheduled for release. This monthly survey will provide an update from recruitment consultants on permanent and temporary recruitment, vacancies and earnings in October, with particular interest on whether the conclusion of the government's furlough scheme the previous month helped to ease some of the recent shortage of available candidates and pressure on pay. After today's surprise BoE decision to keep policy unchanged, Deputy Governor Ramsden and Chief Economist Pill will hold the Monetary Policy Report National Agency briefing. Separately, BoE external member Tenreryo will give a speech titled "Uncertainty and restoring confidence following the pandemic".

UK: New car registrations and production



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Construction PMIs



Source: Refinitiv, Markit and Daiwa Capital Markets Europe Ltd.

Daiwa Capital Markets

European calendar

Today's results

Economic data

Country		Release	Period	**Actual**	Market consensus/ *Daiwa forecast*	Previous	Revised
Euro area		Final services (composite) PMI	Oct	**54.6 (54.2)**	54.7 (54.3)	56.4 (56.2)	-
		PPI M/M% (Y/Y%)	Sep	**2.7 (16.0)**	2.3 (15.4)	1.1 (13.4)	-
Germany		Factory orders M/M% (Y/Y%)	Sep	**1.3 (9.7)**	1.8 (11.3)	-7.7 (11.7)	**-8.8 (10.4)**
		Final services (composite) PMI	Oct	**52.4 (52.0)**	52.4 (52.0)	56.2 (55.5)	-
France		Final services (composite) PMI	Oct	**56.6 (54.7)**	56.6 (54.7)	56.2 (55.3)	-
Italy		Services (composite) PMI	Oct	**52.4 (54.2)**	54.5 (55.6)	55.5 (56.6)	-
Spain		Services (composite) PMI	Oct	**56.6 (56.2)**	55.8 (56.0)	56.9 (57.0)	-
UK		New car registrations Y/Y%	Oct	**-24.6**	-	-34.4	-
		Construction PMI	Oct	**54.6**	52.0	52.6	-
		BoE Bank Rate %	Nov	**0.10**	*0.25*	0.10	-
		BoE Gilt purchase target £bn	Nov	**875**	*855*	875	-
		BoE Corporate bond target £bn	Nov	**20**	*20*	20	-

Auctions

Country		Auction
France		sold €6.52bn of 0% 2031 bonds at an average yield of 0.16%
		sold €1.58bn of 1.75% 2039 bonds at an average yield of 0.44%
		sold €1.66bn of 0.75% 2053 bonds at an average yield of 0.83%
Spain		sold €1.99bn of 0% 2028 bonds at an average yield of 0.044%
		sold €1.32bn of 0.5% 2031 bonds at an average yield of 0.483%
		sold €1.01bn of 2.9% 2046 bonds at an average yield of 1.124%
		sold €700mn of 1% 2031 inflation-linked bonds at an average yield of -1.308%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		GMT	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Euro area		09.00	Construction PMI	Oct	-	50.0
		10.00	Retail sales M/M% (Y/Y%)	Sep	0.2 (1.5)	0.3 (0.0)
Germany		07.00	Industrial production M/M% (Y/Y%)	Sep	1.0 (1.3)	-4.0 (1.7)
		08.30	Construction PMI	Oct	-	47.1
France		07.45	Industrial production M/M% (Y/Y%)	Sep	0.0 (2.5)	1.0 (3.9)
		07.45	Wages Q/Q%	Q3	0.5	0.3
		08.30	Construction PMI	Oct	-	48.9
Italy		08.30	Construction PMI	Oct	-	56.6
		09.00	Retail sales M/M% (Y/Y%)	Sep	0.2 (-)	0.4 (1.9)
Spain		08.00	Industrial production M/M% (Y/Y%)	Sep	0.1 (1.5)	-0.3 (1.8)

Auctions and events

Country		GMT	Event
Euro area		11.00	ECB Executive Board member Panetta speaks publicly in Madrid
UK		00.01	REC/KPMG report on jobs
		12.15	BoE Deputy Governor Ramsden and Chief Economist Pill to deliver a Monetary Policy Report National Agency briefing
		13.00	BoE's Tenreryo due to speak on "Uncertainty and restoring confidence following the pandemic"

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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